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Speech

OPEN SKIES AGREEMENTS AND THE EUROPEAN COURT OF JUSTICE

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I am very happy to be here this morning – and for more reasons than you might think. As I explained at the Forum's last meeting in Washington earlier this year, when I re-entered public service I was told I had to resign prematurely as Chairman of the Forum. I felt pretty guilty about that. My term, and the heavy lifting that goes with it, had only just begun. I felt that I'd managed to add the Forum Chairmanship to my resume without really earning it. Under the circumstances, therefore, the arrival of the Forum's invitation to speak to you today carried special meaning: it meant I'm not *persona non grata* around here after all. That's a great relief.

As you know, the European Court of Justice issued a very important and long-awaited decision three days ago. Because it was immediately the subject of some of the most galactically erroneous reporting in recent history, I want to offer you some facts about what the decision actually said – at least as I understand it -- and some very preliminary thoughts about its implications for the future of trans-Atlantic aviation relations. I should emphasize, of course, that the U.S. Government is still studying the decision carefully and thinking hard about its implications. These remarks, in other words, are essentially a first reaction, and largely a personal one.

The case arose in 1998 as an effort by the European Commission to establish the proposition that bilateral air services agreements between individual Member States of the European Union on the one hand and countries outside the EU on the other – notably the United States -- are contrary to EU law. The Commission argued that only it had the

legal authority – or "competence" in EU parlance -- to represent the Member States in the conduct of air services negotiations with third countries.

U.S. airline officials often discuss the U.S. Government's competence to conduct aviation negotiations, but I suspect they are not talking about our legal authority.

Anyway, the Commission's theory was that, within the EU, competence – legal authority -- for the conduct of aviation relations with third countries has been vested in the Commission since the mid-90's, when the so-called "Third Package" completed the establishment of a single aviation market within the EU. The Commission argued that seven bilateral Open Skies agreements forged between particular Member States and the U.S. subsequent to that time – and the U.S.-U.K. air services agreement -- were contrary to EU law. According to the Commission, the Member States simply did not have the legal authority to enter into those agreements.

A lot of speculation preceded the issuance of the decision – particularly on this side of the Atlantic. What if the Court agreed with the Commission and invalidated our bilateral agreements? Would U.S. airlines continue to enjoy the rights they have to serve European destinations and beyond? Would European airline services to U.S. communities be interrupted? Would U.S. and European airlines still be able to price their trans-Atlantic services without worrying about regulatory restrictions as they can today? Would they be allowed to maintain productive trans-Atlantic marketing and code-sharing alliances, which are predicated most importantly on the guarantee of unrestricted market entry and the open route descriptions that are central features of every Open Skies agreement?

What if EU Member States were prohibited from conducting bilateral negotiations with the U.S. in their own right, but the Commission did not yet have authority to negotiate on behalf of the EU as a whole? We'd have nobody to negotiate with.

Mirror-image concerns, of course, were expressed in Europe.

Last Tuesday, November 5, we got the answers. The European Court of Justice rendered what American lawyers would call a "surgical" decision. Contrary to a great many headlines that appeared in the press, it did not strike down the bilateral agreements that were the subject of the Commission's complaint. Nor did the Court prohibit EU Member States from continuing to conduct negotiations with the U.S. in their own right. The Court certainly did not – and indeed could not -- confer competence on the Commission to conduct negotiations with the U.S., a political decision that can only be taken by the EU Council of Ministers. And most importantly, the decision did not have any immediate impact on the rights of U.S. and European airlines to continue to conduct services pursuant to the challenged bilateral agreements.

Instead, the Court found that certain specific types of provisions in those bilateral air services agreements – because they implicated subject matter that is now the subject

of internal EU regulations that address the rights of non-EU nationals – are contrary to EU law.

Specifically, provisions in bilateral aviation agreements that the Court found objectionable were those that –

- addressed the allocation of slots;
- governed the pricing of intra-European air services – so-called "fifth freedom" pricing provisions;
- addressed computer reservation systems; and
- reserved the right to operate services under the bilateral agreements in question only to airlines substantially owned and effectively controlled by nationals of the EU Member State that is a party to the agreement.

I know that assessments of the decision from this side of the pond are not likely to be of great interest either to the European Court of Justice or to the Commission, but I have to say that, to this observer at least, the decision seems entirely unsurprising. Indeed, American lawyers will be reminded of our own doctrine of pre-emption: the well-established principle that state governments are prohibited from legislating with respect to any subject area "occupied" – and thus pre-empted -- by our national government. Aviation lawyers in particular know about the principle because of a number of important decisions – including some by the U.S. Supreme Court – relating to whether and to what extent state governments retained the ability to regulate airline behavior following Congress's passage of the Airline Deregulation Act in 1978.

What the European Court said – if I can paraphrase it in American terms -- was that certain aspects of civil aviation have been pre-empted by EU regulations, and no EU Member State has the ability to agree to any provision in an air services agreement that runs counter to those regulations. Conversely, those aspects of aviation that the Commission has *not* pre-empted through regulations remain legitimate fodder for bilateral negotiations.

Many of the press stories earlier this week said that the Court struck down "central features" of the aviation agreements between the U.S. and the eight EU Member State defendants.

Let's examine that proposition. As most observers of the aviation negotiating process know, there is only one feature of any bilateral agreement that can legitimately be termed "central." That is the provision that spells out the traffic rights made available by the agreement. These agreements are mainly about one thing: the operation of commercial flights between the territories of the contracting parties, as well as operations from the other party's territory to the territories of non-contracting parties. Without

traffic rights, there would be no purpose in having any agreement at all. Traffic rights, in a real sense, are the whole point of an air services agreement.

The European Court of Justice did not find the provisions awarding traffic rights to be contrary to European law, except in one respect that I will come to in a moment. So the most central feature of all was not struck down by the decision.

Let's consider, then, the provisions that *were* struck down.

First, provisions relating to the allocation of airport slots were held to be contrary to EU law. But the Court also found that not one of the bilateral agreements that were the object of the Commission's complaint contained any such provision. So no action is necessary on that score.

Second, provisions governing the pricing of intra-European air services were also held to be contrary to EU law.

In an earlier day, when airplanes had much shorter range and Fifth Freedom operations represented an important factor in the conduct of economically viable air services, the U.S. fought hard to secure the ability of U.S. carriers to be price leaders in those so-called "beyond" markets. The provision therefore can be seen as a vestige of a bygone era.

Today, particularly in Europe, U.S. combination carriers have mostly abandoned Fifth Freedom operations in favor of code-shared connections with alliance partners. Moreover, the EU itself no longer regulates prices for intra-European air services, so that even all-cargo operators – those who might otherwise want to retain the comfort provided by those Fifth Freedom pricing provisions – can rest easy. And finally, because most of our Open Skies agreements with EU member states already recognize that EU law does not entitle U.S. airlines to be price leaders on intra-EU routes – the agreements even cite the relevant EU regulation -- the ruling actually doesn't affect the pricing opportunities actually available to U.S. airlines today. It is hard to argue, in other words, that these very narrow provisions relating to Fifth Freedom pricing are in any way essential to the integrity of our Open Skies agreements.

Third, the Court found provisions dealing with computer reservation systems objectionable because, again, there are EU regulations on the subject. I know a lot about those provisions because I negotiated a few of them during the 1980's when I was at the State Department. They were important provisions then for two important reasons: First, a few U.S. carriers owned their own systems and felt that they could not compete fairly in Europe unless they were in a position to place their systems in European travel agencies alongside the systems owned by the competing national carriers. Second, the U.S. Government was concerned about the serious bias that it found throughout the European systems at that time.

The situation today is quite different. First, no U.S. airline owns a CRS solely in its own right. Second, as the Court found, the EU does indeed have regulations governing the CRS's deployed in EU territory. The U.S. and the Commission have sparred from time to time over whether EU rules are overly prescriptive and thus impede innovation. That debate aside, we can certainly acknowledge one important feature of those rules: Their underlying purpose is to ensure fair competition. Indeed, our European counterparts think their rules are better than ours in that regard. The point now is not whether EU rules are better than U.S. rules or *vice versa*; the point is that we both have rules! Some of our Open Skies agreements even include an explicit statement acknowledging that in the event of a conflict between EU rules and the rules set forth in the agreement, our EU partners will have to abide by the EU rules. Again, therefore, the continuing requirement for these CRS provisions in Open Skies agreements with our EU trading partners seems open to question.

Finally, the European Court held contrary to EU law all provisions allowing the U.S. and our EU trading partners to prohibit air services under a bilateral agreement by any airline that is not a citizen of the EU Member State party to the agreement. Because EU law, dating as far back as the Treaty of Rome, includes the right of establishment and national treatment for all Member States, any provision in which an EU Member State agrees to allow the United States to veto services by an airline owned or controlled by citizens of a second EU Member State represents discrimination by the first Member State against the second. In other words, Germany is not allowed to discriminate against the airlines of France by agreeing that the U.S. may reject services offered between Germany and the U.S. by any carrier that isn't substantially owned and effectively controlled by German citizens – which Air France certainly is not.

This is the element of the Court's decision that is most interesting and that is likely to have the most far-reaching implications.

The first thing to be said about this finding is that it's all about Europe; not about the U.S. To refer again to the press, I've seen accounts suggesting that the clever Americans have established a huge advantage over our European trading partners by retaining these nationality clauses in our bilaterals. That characterization misses some very important points about U.S. aviation policy.

First, as you know, U.S. policy since 1992 has been to seek Open Skies agreements with as many partners as possible. We are up to 59 such agreements, including eleven with member countries of the EU. When the U.S. signs an Open Skies agreement with another country, it agrees to allow airlines of that country to fly to any airport in the vast landmass of the United States from anywhere in the world, usually subject only to the requirement that the flight serves a point in the carrier's home territory. Because the U.S. has Open Skies agreements with eleven EU Member States, we have already agreed that flights from the airlines of those countries can depart Europe from any city in any of those countries.

Second, the offending nationality provisions are *permissive*. In other words, they do not *require* the U.S. to reject a carrier originating flights to the U.S. from a country on the ground that it isn't owned and controlled by citizens of that country. Indeed, the U.S. from time to time has waived its objections under such clauses in the interest of ensuring fuller participation in the aviation market by certain trading partners and to encourage competition. And we have agreements with partners from Scandinavia to Africa to the Caribbean in which we have worked out understandings that explicitly accommodate operations by airlines characterized by multinational ownership.

Finally and most important, we entered into a multilateral Open Skies agreement a couple of years ago with four of our partners in APEC – the Asia-Pacific Economic Cooperation forum. The partners are Brunei, Chile, New Zealand, and Singapore. Peru acceded to the agreement earlier this year and we have actively encouraged other trading partners – both within and outside of APEC – to join as well.

That agreement is notable for its departure from the conventional approach to airline nationality. The agreement expressly prohibits any signatory country from objecting to operations by any airline that has its principal place of business in the country from which its flights originate on grounds that it is not owned by citizens of that country. The airline must be controlled by such citizens, and the benefit is available only to airlines of countries that are parties to the multilateral agreement, but the agreement nevertheless represents a significant step forward in the liberalization of the traditional nationality clause.

I hope that I have made clear here today that the United States is prepared to look creatively at nationality clauses. We certainly do not treat the traditional formula as sacrosanct.

The last point I would make about the Court's decision relates to the prospects for conducting negotiations with the EU as an entity. As I indicated earlier, the Court did not and could not confer an exclusive negotiating mandate on the European Commission. But the U.S. is not celebrating that fact. We have said for many years that we look forward to the day when U.S.-EU negotiations will be possible.

The U.S. quest for liberalization in air services has not abated. In Europe and elsewhere, we have sought that liberalization wherever we could find it. We might have saved a lot of money and a lot of time if we could have negotiated with the Commission in Brussels instead of conducting talks with the Member States one by one. But negotiating separately with each Member State has resulted in a broad array of trans-Atlantic air services that are already largely deregulated – at least compared to the regimes in place a decade ago, prior to our first Open Skies agreement with the Netherlands. The bilateral option is still available to the U.S., and you can be sure that we will continue to pursue it where further market opening initiatives appear to be within reach.

The question now is this: How can we take liberalization to the next level? In my judgment, an essential prerequisite is a like-minded partner on the other side of the negotiating table that represents an airline industry and an aviation market comparable to our own. The EU airline industry, taken as a whole, and the EU aviation marketplace, taken as a whole, certainly satisfy that test. Will it be a long, difficult negotiation? Of course. Will we need time to transition to a more liberal regime? Probably. But such negotiations would compel both sides to think seriously about how the trans-Atlantic market can be made more robust and competitive. And the end result, by creating a more open market and the economic and structural opportunities that come with it, will be a healthier airline industry and increased consumer welfare on both sides of the Atlantic.

We have no control whatsoever over the timing, form, or content of a possible Commission mandate. We will continue to watch and wait. Some speculate that this week's decision by the European Court of Justice will accelerate the delivery of a mandate to the Commission. We look forward to hearing from our European counterparts whether they think that will happen, and if so, when.

Many thanks for allowing me to share these thoughts with you this morning.

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